

## MONTHLY MARKET PROFILE: 08/10/02

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The beef industry is currently operating in a business environment where uncertainty seems the norm. Perhaps most appropriately defined as being on the “edge of chaos”; a term that describes conditions in which industries and organizations are forced to experience transformation. That process is often extremely problematic and painful. The most difficult to manage are the “...non-routine challenges... These challenges often demand a leap in capability, and solutions are unproven or unknown. In these instances, nimbleness and agility are essential, and tapping the full potential of the organization [or industry]...becomes imperative. This is not a ‘maybe’ or a ‘sort of’. It’s a deal breaker.” (Pascale et al.) The beef industry is facing a myriad of concurrent challenges whose source is both internal and external, some routine, many are not, including: increasingly efficient competition, globalization, activism, drought, animal disease, equity drain, beef recalls, government regulation, and litigation. The sum total equates to ambiguity about the industry’s future direction. Given those developments, and the accelerating pace at which they occur, it becomes progressively imperative to monitor, analyze AND interpret news and information which potentially provide the impetus for change and instability.

The market’s prevailing sentiment is that 2002 seasonal lows have been established and fed cattle are poised for some recovery in coming months. July, August and September typically mark the time of year in which the fed market bottoms out. Large supplies late in the 2<sup>nd</sup>-quarter advanced movement to the downside earlier in the summer than typically expected. Since then, the market has primarily traded sideways and has found support in the \$62-3 range. Meanwhile, the October Live Cattle contract (\$68-9) is trading at a significant premium to cash. Several analysts have provided forecasts that exceed CME’s bullishness with expectations of trade in the mid-\$70’s for the fall. Upside potential of that magnitude will likely be tempered by several factors.

First, beef production remains sizeable and there appears no reason to expect reversal of that trend. June’s beef production was equal to 2.3 bil lb resulting from total slaughter of nearly 3.1 mil head; 1% ahead and 2% below last year’s pace, respectively. The production-slaughter discrepancy is explained by persistently heavy carcass weights. June slaughter weights (1236 lb) were well ahead of last year (38 lb) while steer carcass weights exceed last year’s average-to-date by 30 lb. On that note, total beef production to date (13.21 bil lb) is running 4% ahead of last year’s pace. Average weekly beef production, from July through December, typically exceeds the first six months by 1%; if that trend remains in place the beef industry is on pace to produce over 26.5 bil lbs in 2002.

Recall that total placements for the months of April and May were below last year’s pace. However, placement patterns during those two months were heavily biased towards yearlings placed against the September/October time frame. Those placements will allow for limited marketing flexibility and will need to be reckoned with as we approach fall. Weekly slaughter rates will be very important to monitor as we work through August and into September. Carryover appears to be manageable but could quickly become burdensome if a standoff occurs especially since carcass weights provide no indication of moderation.

Secondly, beef supply has been confounded with large supplies from competing meat proteins throughout the year. USDA’s July 19 Cold Storage offered no friendly surprises; poultry, pork and beef supplies (as of June 30) are 26%, 16% and 31% ahead of year ago and currently total 1.5 bil, 396 mil and 490 mil lb, respectively. Total meat supplies in cold storage equal 2.4 bil lb; 25% larger than last year.

Thirdly, beef demand must be monitored carefully. Beef movement has been active during the past several months. However, the industry needs to keep watch on the economy. Consumers are increasingly concerned about their financial prosperity. The Conference Board

reported that July's Consumer Confidence Index had slipped for the second month in a row to 97.1, the lowest since February. More troubling, though, the Consumer Expectations Index also fell (107.2 in June to 95.7 in July). The Conference Board noted that consumers are becoming anxious about the current economic environment and may begin to slow down on spending and consumption regardless of sales and various purchasing incentives.

Drought is playing a major factor on beef industry economics. The western half of the United States has received no relief. Many cow/calf producers have been forced to implement emergency strategies to survive and liquidation has often been, or remains, the only option. Interestingly enough, cow slaughter has remained relatively constant; these females are finding homes in areas where grass has been relatively plentiful. Implications for the fall remain to be seen but will likely be felt on several fronts that are especially important to cow/calf producers. Hay is becoming difficult to find and increasingly expensive. Wheat pasture will likely be limited and could diminish demand for feeders. And dry conditions in the western Corn Belt, along with its recent creep into the eastern portion, have been friendly to the corn market. USDA's August Crop Production report revised this year's production down to 8.89 billion bushels; the lowest production since 1995. CBOT December corn was trading around \$2.75/bu following the report. These factors, coupled with chronic feedyard losses, have initiated a large amount of negative sentiment among buyers.

Reluctance regarding fall delivery commitments seems to be the rule right now. That has led to a resurgence of interest in retained ownership among cow/calf producers. Certainly, retained ownership is not a viable option for everyone. However, it is a marketing alternative which many operations have benefited from, and at the very least, one which producers should become familiar with in order to make intelligent, well-informed marketing decisions. For many producers, though, the consideration of retained ownership has occurred somewhat begrudgingly. The industry's recent attention on price discovery and volatility has heightened anxiety regarding risk exposure associated with extending the ownership period.

Those issues aside, whether one opts for traditional marketing, or chooses an alternative, it is essential to remember that some type of risk is associated with any marketing avenue regardless of the decision. All marketing decisions should be carefully considered within the framework of the operation's tolerance for risk; that reflection also allows for proper implementation of various strategies to offset risk exposure once a commitment has been made. With that background in mind, I recently did some analysis of weekly fed cattle price distribution during the past five years. My purpose is to provide some additional insight into various hedging/price protection opportunities through the feedyard ownership period. (It is not my intention to address various pricing implications within the industry; on that subject, I would welcome any comments you might have regarding the data presented.)

The data is outlined in a table below. Fed cattle prices are categorized relative to "A" (above) weeks (defined as trading above the 5-year average) and "B" (below) weeks (defined as trading below the 5-year average). The 5-year average fed price is equal to \$67.07/cwt. Additionally, I have included the associated means of the light-Choice cutout, drop values and replacement feeder costs associated with the respective categories.

With respect to risk management and pricing strategies there are several items which are important. Of special significance, fed cattle prices have not been normally distributed during the past five years. The market's movements to the upside have been of shorter duration than those movements to the downside; the number of "B" weeks exceeds "A" weeks by a margin of approximately 3 to 2. Alternatively, though, movements to the upside tend to be more dramatic versus those to the down side; "A" weeks averaged \$4.70/cwt above the mean (\$67.07/cwt) while "B" weeks possessed a \$3.34/cwt disadvantage. Interestingly enough, the "B" week mean equals \$63.73/cwt – very near where the industry has found support during the past several weeks. The historical data will provide some useful and realistic price objectives for risk management strategies as we begin to place cattle on feed this fall.

PRICE DISTRIBUTION: CATEGORIZED BY FED STEER AVERAGE DEVIATION <sup>ab</sup> (\$/cwt)												
YEAR	<u>"B" WEEKS<sup>c</sup></u>				<u>"A" WEEKS<sup>d</sup></u>				<u>OVERALL</u>			
	FED	CUTOUT	DROP	YRLNG	FED	CUTOUT	DROP	YRLNG	FED	CUTOUT	DROP	YRLNG
<b>1997</b>	65.22	102.06	8.70	74.82	68.24	105.24	9.20	71.54	66.09	102.99	8.85	73.87
# WEEKS	37				15							
<b>1998</b>	61.76	99.77	7.04	70.97	---	---	---	---	61.76	99.77	7.04	70.97
# WEEKS	52				---							
<b>1999</b>	64.33	108.59	6.75	72.33	69.58	117.89	7.77	79.93	65.54	110.74	6.98	74.08
# WEEKS	40				12							
<b>2000</b>	65.29	110.33	8.35	85.65	70.84	119.30	7.88	85.78	69.67	117.41	7.98	85.75
# WEEKS	11				41							
<b>2001</b>	64.29	112.99	7.38	84.29	74.71	125.08	8.85	88.18	72.30	122.29	8.51	87.27
# WEEKS	12				40							
<b>OVERALL</b>	63.73	104.47	7.48	74.40	71.77	119.33	8.41	84.00	67.07	110.67	7.87	78.38
# WEEKS	152				108							

<sup>a</sup> Fed=Cattle-Fax weekly fed steer price, Cutout=light-Choice cutout, Drop=hide and byproducts, Yrlng=Cattle-Fax weekly 750 lb steer price

<sup>b</sup> Overall five-year fed steer mean = \$67.07/cwt

<sup>c</sup> "Down" weeks = weeks in which fed trade occurred at less than \$67.07/cwt

<sup>d</sup> "Up" weeks = weeks in which fed occurred greater than \$67.07/cwt

USDA Cattle-on-Feed Report: July 19, 2002							
Date	Category	Total (000 head)	<u>U.S.</u>		Total (000 head)	<u>7-State</u>	
			2001	versus 5-yr avg		2001	versus 5-yr avg
1-Jul-02	Cattle on Feed	10487	-5%	+7%	9056	-4%	+8%
June	Marketings	2076	-2%	-1%	1773	-3%	-1%
June	Placements	1644	-16%	-2%	1422	-16%	-1%

Month	Monthly Placements (000 head) and Percent of Year-Ago (%)								Total	
	<u>Placement Weight Categories (lb)</u>									
	<600		600-699		700-799		800+			
Jan-02	381	76%	614	86%	734	111%	437	114%	2166	96%
Feb-02	261	78%	411	102%	664	159%	474	146%	1810	122%
Mar-02	314	95%	372	89%	702	114%	565	116%	1953	105%
Apr-02	210	63%	255	66%	512	104%	476	140%	1453	94%
May-02	350	70%	445	87%	760	95%	712	126%	2267	96%
Jun-02	341	81%	356	81%	513	81%	434	92%	1644	84%
Total	1857	77%	2453	86%	3885	107%	3098	120%	11293	98%

## PRICE SUMMARY

ITEM	WEEK ENDING:				
	9-Aug	2-Aug	26-Jul	19-Jul	12-Jul
Slaughter Steers (\$/cwt)	61.87	62.63	62.77	63.55	63.02
Light Choice Cutout: 600-750 LB (\$/cwt)	109.04	109.36	110.26	109.45	107.40
Light Select Cutout: 600-750 LB (\$/cwt)	102.43	104.26	106.01	104.45	103.57
Hide and Offfall (\$/cwt)	7.56	7.56	7.57	7.25	7.33
USDA Slaughter Weights (lb)	1253	1251	1248	1246	1242
USDA Steer Carcass Weights (lb)	833	830	830	828	822
Cattle-Fax Days on Feed	147	149	150	144	152
Steer Calf: 450 LB (\$/cwt)	96.79	97.19	97.86	97.75	97.58
Steer Calf: 550 LB (\$/cwt)	86.48	86.86	87.73	87.69	87.21
Yearling Steer: 650 LB (\$/cwt)	80.94	81.06	81.25	81.30	80.90
Yearling Steer: 750 LB (\$/cwt)	77.00	77.17	76.70	76.80	76.42
CME Feeder Cattle Index (\$/cwt)	77.99	78.34	77.73	77.15	77.30
Yearling:Fed Steer Ratio (%)	124.45	123.22	122.19	120.85	121.26
Slaughter Cows: Utility/Commercial (\$/cwt)	37.15	37.29	37.31	37.18	38.64
Slaughter Cows: Canner/Cutter (\$/cwt)	32.17	32.38	32.22	31.99	33.00
Cow Cutout (\$/cwt)	80.78	83.08	83.77	85.18	86.27
Corn (basis Omaha: \$/BU)	2.35	2.32	2.30	2.11	2.01
Cattle Harvest (000 head)	703	713	700	710	711
Beef Production (million lb)	537.8	544.9	537	542.1	543.1

Source: Cattle-Fax, CME Inc., USDA